

Pursuant to Article 44 paragraph 2 point 3 of the Central Bank of Montenegro Law (OGM 40/10, 46/10) and Article 58 paragraph 2 of the Banking Law (OGM 17/08, 44/10), the Council of the Central Bank of Montenegro, at its meeting held on 5 March 2012, passed the following

D E C I S I O N
On the Manner of Calculating Bank Exposures

1. Basic provision

Subject Matter

Article 1

This decision regulates the manner of calculating banks' exposures to a single party or a group of connected parties.

2. Calculating the exposure limit

Items to be included in calculation of exposures

Article 2

The following items shall be included in calculating bank's exposure to a single party or a group of connected parties:

- 1) On-balance sheet items of a bank;
- 2) Off balance sheet items under the table referred to in Article 13 of the Decision on Capital Adequacy of Banks (OGM 38/11), before the application of conversion factors and risk weights.

By way of derogation from paragraph 1 above, the following items shall not be included in the calculation of exposures:

- 1) exposures deducted from bank's own funds;
- 2) in the case of spot foreign exchange transactions, exposures incurred in the ordinary course of settlement during the two working days following payment;
- 3) in the case of spot transactions for the purchase or sale of securities, exposures incurred in the ordinary course of settlement during five working days following payment or delivery of the securities, whichever the earlier;
- 4) exposures arising from delayed receipts of funds and other exposures arising from customer's activity and maturing at the latest on the following business day, in case of providing payment services, including money transfer services, as well as clearing and settlement services in local or foreign currency, financial instruments clearing, correspondent banking and custody services;
- 5) intra-day exposures to institutions providing payment services, including money transfer services, clearing and settlement services in local and foreign currency and correspondent banking services;
- 6) exposures in the form of minimum reserve requirements, maintained at the accounts with the Central Bank of Montenegro.

Book value of the items referred to in paragraph 1 above deducted by loan loss provisions shall be used for calculating the exposures.

Treatment of exposures from trading book

Article 3

Notwithstanding Article 2 paragraph 1 of this Decision, banks calculating capital requirement for market risks shall calculate exposures to a single party or a group of connected parties as a sum of total exposures from trading and banking book.

Total exposure to a single party arising from trading book shall be calculated as a sum of the following items:

- 1) the excess of bank's long positions over its short positions in all financial instruments issued by a party in question, the net position in each different instruments being calculated in accordance with the provisions of the Decision on capital adequacy of banks regulating the calculation of capital requirement for market risks;
- 2) the net exposure of a bank, in the case of the underwriting of a debt or an equity instrument, calculated in accordance with Article 214 of the Decision on capital adequacy of banks,
- 3) the exposures in case of transactions or contracts resulting in settlement/delivery risk or counterparty credit risk, calculated in the manner laid down in the provisions of the Decision on capital adequacy of banks on capital requirements for settlement/delivery risk and counterparty credit risk.

The exposure from trading book to a group of connected parties shall be calculated by summing up all exposures to all persons from the group of connected parties calculated in accordance with paragraph 2 above.

Specific exposures treatment

Article 4

For the exposures referred to in Article 16, points 13 and 15 of the Decision on capital adequacy of banks, where there is an exposure to underlying assets, the bank shall, for the purpose of determining exposure to a single party or a group of connected parties, assess each scheme, its underlying exposures, or both. For this purpose, the bank shall evaluate the economic substance and the risk inherent in the structure of the transaction.

Use of credit risk mitigation techniques

Article 5

If a third party guarantees for the exposure to a single party directly and unconditionally or if the exposure is secured by collateral provided by a third party, the bank may treat such exposure as exposure to a third party up to a guaranteed or secured amount, if the third party is not connected with a party for which obligation it guarantees.

Guarantees referred to in paragraph 1 above shall be considered also credit derivatives recognised as risk mitigants, in accordance with the provisions of the Decision on capital adequacy of banks regulating credit risk mitigation techniques, other than credit linked notes (CLN).

Where the guarantee is denominated in a currency other than the currency of the exposure, the amount of the exposure shall be adjusted in accordance with the provisions of Article 117, and maturity mismatch of the exposure and of the guarantee shall be treated in compliance with the provisions of Articles 120-122 of the Decision on capital adequacy of banks.

The treatment of exposures in the manner set forth in paragraph 1 above shall not apply if:

- 1) the eligibility requirements for recognition of funded or unfunded credit protection set out in the Decision on capital adequacy of banks are not met;
- 2) in case of provided protection, there is a maturity mismatch between the underlying exposure and the collateral, which is treated in accordance with Article 120 paragraph 3 of the Decision on capital adequacy of banks.

Deductions

Article 6

In calculating the exposures, for the purpose of determining large exposure to a single party or a group of connected parties, the bank may completely exclude from the calculation the following exposures:

- 1) exposures constituting claims on central governments, central banks, international organisations or multilateral development banks which, unsecured, would be assigned a 0% risk weight according to the Decision on capital adequacy of banks;
- 2) exposures secured by unconditional guarantees of the central governments, central banks, international organisations, multilateral development banks or public sector entities, where unsecured claims on the entity providing the guarantee would be assigned a 0% risk weight according to the Decision on capital adequacy of banks;
- 3) exposures to regional governments or local self-governments, or guaranteed by them, where unsecured claims on those entities would be assigned a 0% risk weight according to the Decision on capital adequacy of banks;
- 4) exposures secured by collateral in the form of cash deposits, placed within the lending bank or within a bank or other credit institution which is the parent undertaking or a subsidiary of the lending bank. For that purpose, cash received

- under a credit linked note issued by lending bank and loans and deposits of a counterparty, which are subject to an on-balance sheet netting agreement recognised under Article 83 of the Decision on capital adequacy of banks;
- 5) exposures secured by certificates of deposit, issued by the lending bank, its parent undertaking or its subsidiary and lodged with either of them;
 - 6) exposures arising from undrawn credit facilities that are classified as low-risk off-balance sheet items under Article 13 of the Decision on capital adequacy of banks, provided that an agreement has been concluded, under which the facility may be drawn only if it has been ascertained that it will not cause exceeding of large exposure limit under Article 58, paragraph 1 of the Banking Law;
 - 7) covered bonds falling within the terms of Article 46 of the Decision on capital adequacy of banks.

In calculating exposure amounts, for the purpose of determining large exposures, bank shall include at least 20% of the following items in the calculation:

- 1) exposures guaranteed by regional governments or local self-governments, if unsecured claims to those entities would be assigned a 20% risk weight according to the Decision on capital adequacy of banks;
- 2) exposures of the bank, including also equity participation or other types of investments, to its superior bank, subsidiaries of superior bank and its subsidiaries if they are subject to consolidated supervision in accordance with the applicable regulations in the European Union or equivalent supervisory standards on consolidated basis applied in third country.

In calculating exposure amounts, for the purpose of determining large exposures, bank shall include at least 50% of the following items in the calculation:

- 1) exposures arising from off-balance-sheet documentary credits and undrawn credit facilities, which are classified in medium to low risk category in accordance with Article 13 of the Decision on capital adequacy of banks;
- 2) exposures under Article 35 paragraph 1 points 1 and 2 of the Decision on capital adequacy of banks, as follows:
 - exposures secured by mortgage or fiduciary on residential property which fall within 35% risk weight requirements under the Decision on capital adequacy of banks,
 - exposures secured by mortgage or fiduciary on commercial property which fall within 50% risk weight requirements under the Decision on capital adequacy of banks;
- 3) exposures in relation to leasing transactions over residential property, where the lessor retains full ownership of the residential property for the period prior to exercising the right to the final purchase by the lessee, as well as exposures related to property leasing transactions concerning commercial property, provided that the value of the property is subject to prudent valuation standards and the property is fully constructed, leased and produce appropriate rental income.

Calculation of exposure amounts

Article 7

The exposures under Article 2, paragraph 1 hereof shall be summed up after taking into account the credit risk mitigation effects and deductions under Article 6 hereof.

Where single parties are found to be connected on a consolidated or non-consolidated basis, the exposures to them shall be summed up and reported as one exposure.

Banks calculating capital requirements for market risk shall calculate exposures to a single party or a group of connected parties as the sum of their trading and banking book exposures.

The exposures to derivatives referred to in Annex 1 of the Decision on capital adequacy of banks shall be calculated in accordance with the methods laid down in the provisions thereof on calculation of exposures to counterparty credit risk.

Comprehensive approach for credit risk mitigation

Article 8

For the purposes of calculating the amount of large exposures, the bank applying the Financial Collateral Comprehensive Method under the Decision on capital adequacy of banks may use the fully adjusted exposure value as calculated in accordance with the methods laid down in the provisions of the Decision regulating the calculation of adjusted exposure value.

A bank that applies the treatment under paragraph 1 above shall conduct, in calculating exposure amount, periodic stress tests of credit risk concentrations, including realisable value of any collateral taken.

Stress tests shall examine the risk arising from potential changes in market conditions that could adversely affect capital adequacy of the bank, as well as risks associated with uncertainties in the realisation of the collateral in emergency situations.

The bank shall demonstrate to the Central Bank of Montenegro that stress tests applied are reliable and appropriate to the risk assessment under paragraph 3 above.

If the results of the stress test indicate a lower realisable value of the collateral taken than determined according to the treatment under paragraph 1 above, the value of the collateral shall be reduced accordingly in calculating the value of the large exposure.

A bank that applies the treatment under paragraph 1 above shall include in its internal rules the following elements for concentration risk:

- 1) policies and procedures for controlling the risk arising from maturity mismatches between underlying exposures and provided credit protection;

- 2) policies and procedures for adjustment of value of collateral within the meaning of paragraph 5 above;
- 3) policies and procedures in relation to risk arising from the application of concentration risk mitigation, and in particular indirect exposures, such as exposures to one issuer of securities received as collateral.

3. Transitional and closing provisions

Article 9

Exposures of banks incurred until the effective date of this Decision, whose amounts calculated by applying this Decision exceed legally prescribed exposure limits and where exceeding these limits resulted exclusively from the manner of calculation of exposure laid down in this Decision, banks may reduce within the prescribed frameworks by reducing the exposures within the deadlines and in the manner prescribed by their respective agreements.

In period from the effective date of this Decision until the reduction of the exposure within the prescribed framework, banks shall not sign new agreements or change the existing agreements if in doing so they increase those exposures.

Article 10

Article 10 of the Decision on Minimum Standards for Credit Risk Management in Banks (OGM 60/08, 41/09) shall cease to be valid on the day this Decision enters into force.

Article 11

This Decision shall enter into force on the eighth day following that of its publication in the Official Gazette of Montenegro, and it shall be applied from 1 April 2012.

THE COUNCIL OF THE CENTRAL BANK OF MONTENEGRO

Decision no. 0101-4014/28-2
Podgorica, 5 March 2012

CHAIRMAN
G O V E R N O R,
Radoje Žugić, m.p.